



UNITED STATES ENVIRONMENTAL PROTECTION AGENCY  
WASHINGTON, D.C. 20460

FILES

MAY 9 1990

OFFICE OF  
WATER

MEMORANDUM

SUBJECT: Revised Owner/Operator Handbook for  
Class II Financial Responsibility Demonstrations  
UIC Program Guidance # 67

FROM: Michael B. Cook, Director  
Office of Drinking Water (WH-550E)

TO: Water Management Division Directors  
Regions I - X

Attached is a pre-publication copy of the subject document for the use of your UIC program staff in communicating recent changes in financial responsibility (FR) demonstrations to the Class II regulated community in EPA administered programs. The revisions to the Handbook are the result of the UIC program's FR Workgroup's recommendations. The document also incorporates comments from a recent round of Regional review.

The major changes instituted by this development and review process focused on increasing the stringency of FR demonstrations to assure that injection wells are properly plugged and abandoned at the end of their useful life. To that end, companies using financial statement demonstrations must now pass the financial test annually, must meet all five of the test ratios (rather than the previously required four), and must meet a minimum net worth criterion of one million dollars. These changes are recommended for inclusion in compliance reviews and permit up-dates as soon as practical.

Also attached for your information is a summary of the issues and responses raised during the review process. Copies of the printed document will be forwarded to those Regions which have requested them.

Please contact George Hoessel of the UIC Branch at 382-5532 if you have any questions on this matter.

Attachments (2)

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## Introduction

The U.S. Environmental Protection Agency established the Underground Injection Control (UIC) program under the authority of the Safe Drinking Water Act of 1974. In States that have chosen not to administer the program, EPA is required by the Act to implement it. As part of this program, the owners or operators of Class II injection wells associated with oil and gas production must "maintain financial responsibility and resources to close, plug, and abandon the underground injection operation" (40 CFR Sections 144.28 (d) and 144.52 (a) (7)) which are acceptable to EPA.

(The UIC program regulations are found in Parts 124, 144, 145, 146, and 147 of Title 40 of the Code of Federal Regulations and are available from the Regional EPA offices. The regulations are usually cited as 40 CFR Parts 124, 144, 145, 146, and 147.)

In States where EPA administers the program, Class II well owners or operators must satisfy the financial responsibility requirement by submitting a financial mechanism that meets the approval of the EPA Regional Administrator or his designated UIC Program Director. You may choose one of several mechanisms to show that you maintain adequate financial resources to properly close, plug and abandon an injection well. Options include such financial instruments as surety bonds, trust funds, and letters of credit, as well as financial statements. Financial statement demonstrations must be submitted **annually**, while the other mechanisms will be updated at the UIC Program Director's discretion.

This booklet has been prepared by EPA to help Class II injection well owners and operators in federally admini-

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**Who Should  
Read This  
Booklet?**

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**EPA Regional Map**



The federal financial responsibility requirements broadly apply to everyone who owns or operates injection wells of any of the five classes in any State or U.S. territory. This booklet, however, pertains only to the owners and operators of Class II injection wells in States, territories, and Indian lands where EPA administers the UIC program. These programs are termed "Direct-Implementation" programs. A list of Direct Implementation States is presented in Appendix A. (The authority to run a State program is called "Primacy." States that have such authority are called "Primacy" States.)

When you apply for a new permit to construct and operate wells, you must supply up-to-date information that shows you will have sufficient financial resources to close, plug, and abandon your wells properly at the end of their useful life. Owners and operators of rule-authorized wells are also required to meet this responsibility. If you request that the permit or rule authorization for an existing well(s) be transferred to you as a new owner or operator, you must demonstrate your financial responsibility by the date that the transfer becomes effective. EPA has proposed amended regulations to require advance notification of transfers and to hold the original owner/operator liable until the new owner or operator supplies an acceptable demonstration. If you are unsure whether you must comply with these financial requirements or with the UIC regulations, contact EPA's office in the Region where your wells are located. Appendix B lists EPA's Regional Offices, their addresses, telephone numbers, and the States they cover.

## UIC Financial Responsibility Demonstrations

Options (Coverage Classes)	Financial Instrument		Financial Statement
	Full Coverage	Blanket Coverage	Financial Statement Coverage
Mechanisms (Instruments)	Letter of Credit + Standby Trust Fund	Surety Bonds	Trust Fund
	Financial Guarantee Bond + Standby Trust Fund	Performance Bond + Standby Trust Fund	Financial Statement + Chief Financial Officer's Letter + One of the Following: <ul style="list-style-type: none"> <li>• "Full" Auditor's Opinion,</li> <li>• "Glossy" Annual Report,</li> <li>• SEC 10K Report, or</li> <li>• FERC Form 2</li> </ul>

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## Financial Responsibility Mechanisms

### Financial Instruments

The instruments which you may use to demonstrate your financial responsibility are designed to ensure that funds will be available to EPA to plug your injection wells if the need arises. EPA's requirements for each financial instrument are discussed below. EPA may fully or partially release certain instruments as wells are plugged and abandoned, or as acceptable substitute demonstrations are made. EPA may require increases in the amount of financial responsibility coverage to reflect higher plugging and abandonment costs or the addition of new wells. Sample forms of each instrument are available from the EPA Regional Offices.

### Surety Bonds

A **surety bond** is a guarantee by a surety company that specified obligations--such as plugging and abandoning class II injection wells--will be fulfilled. You may use one of two types of surety bond as a financial responsibility demonstration. Both require the establishment of a standby trust fund to receive, on the behalf of EPA, any money that the surety company may pay. Standby trusts are discussed on page 10.

A **financial guarantee bond** ensures that the surety company, from which you obtain the bond, will fund a standby trust in the amount the bond guarantees. Your trustee, who is in charge of the standby trust, would, at the direction of EPA, use the money to pay for proper plugging of the well or wells covered by the bond.

An alternative to the financial guarantee bond is the **performance bond**. This type of bond guarantees that, if you fail to properly plug specified wells, the surety company will either plug them for you or pay the amount

You may cancel a surety bond only if you have the EPA Regional Administrator's or the UIC Program Director's written consent. You may get that consent only after providing a substitute financial instrument or after you have properly plugged the wells covered by the surety bond that you want to cancel.

## Letters of Credit

A letter of credit guarantees that a set amount of money will be available to a specified party under certain conditions. If you use a letter of credit to demonstrate financial responsibility, it must provide that funds will be paid into a standby trust if you fail to plug your injection wells properly. EPA requires that the actual letters of credit be submitted as proof of financial responsibility and that they:

- Be issued by a bank or other institution whose operations are regulated and examined by a State or federal agency. Most commercial banks and some savings and loan institutions and credit unions are the usual sources of this financial instrument.
- Require payment of funds into a standby trust that names EPA as the beneficiary if you fail to meet plugging requirements.
- Identify, by their number and project name, the specific wells covered by the letter of credit.
- Require that the issuing institution give you and EPA 120-day notice if it plans not to reissue the letter of credit.

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the wells covered by the trust, you can ask the EPA Regional Administrator or UIC Program Director to release the fund's interest income to you. Otherwise, income generated by the fund's investments is added to the trust.

As the grantor, you must name a trustee whose responsibilities will include:

- Investing, with your guidance and in accordance with provisions of the trust and applicable legal principles, the funds you deposit,
- Providing EPA with an annual valuation of the fund, and
- Accepting additional deposits or releasing funds as you drill new wells or plug old ones with the concurrence of EPA.

As wells are plugged, EPA may approve payments from the fund to reimburse you for the cost of plugging, or the Agency may delay payments until all the wells covered by a trust are plugged and certified. The latter case is used if it appears, when plugging starts, that the entire operation may cost more than the trust fund contains. EPA may also approve refunds if:

- The value of the trust fund exceeds the estimated plugging costs,
- You substitute another financial instrument for the trust fund, or

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- Specify the conditions under which EPA may authorize payments to meet plugging costs or to return funds to you, the grantor.

The trustee you select to oversee the trust should be a "neutral" party whose connections to you do not pose any potential for a conflict of interest. The bank you normally do business with is an example of a neutral trustee. Although some States authorize attorneys to serve as trustees, the attorney who represents you or your firm could present a potential conflict of interest. Consequently, your attorney would not be acceptable to EPA as a trustee.

## Financial Statements

You may not have to provide a financial instrument to demonstrate that you have sufficient resources to plug your injection wells properly. If your company meets the financial tests described in the next section of this booklet, you can use a financial statement to show EPA that you are likely to close, plug, and abandon your wells according to regulations and your EPA-approved plugging and abandonment plan.

The financial statement demonstration is made in a form provided by the EPA Regional Office. It includes the form letter which your Chief Financial Officer (CFO) or similar executive must provide certifying that your company meets EPA's financial requirements to qualify for making a financial statement demonstration of responsibility. The financial statement uses audited information from your company's income statement and balance sheet to calculate a number of financial ratios.



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## Financial Coverage Criteria

Criterion	Explanation
History of plugging wells	Have you plugged wells in accordance with applicable regulations in the past? If so, EPA believes you are likely to do so in the future.
Remaining economic life of production fields or leases	Are you producing from at least one field or do have at least one lease in the state or territory with an estimated remaining economic life of at least 5 years? If so, EPA feels you are likely to remain in business until the Agency conducts its periodic reviews.
Number of years in business	Have you been in the oil and gas business at least 5 years? Your financial performance will have more significance if the answer is yes.
Number of production fields	Are you producing from more than one field in a state or territory? If you are, then you are less likely to deplete all your resources at the same time. Consequently, you are more likely to be in business when EPA conducts its periodic reviews.
Number of wells	How many injection wells and production wells are you operating? This will influence your choice of coverage.
Estimated Cost of Well Plugging	Estimate costs which should correspond to charges submitted to EPA on the plugging and abandonment plan.
Financial condition	Can your company pass the financial ratio tests in this section? If your company's financial position is strong, you are more likely to be able to plug your wells properly in the future.

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## EPA Financial Test

*Successful Applicants Must Meet the 5 Ratio Thresholds and have a minimum net worth of \$1 million.*

Type of Ratio	Formula	Threshold
1) Debt-Equity Ratio	$\frac{\text{Current Liabilities}}{\text{Net Worth}}$	< 1.0
2) Debt-Equity Ratio	$\frac{\text{Long Term Liabilities}}{\text{Net Worth}}$	< 2.0
3) Liquidity	$\frac{\text{Current Assets} - \text{Current Liabilities}}{\text{Total Assets}}$	> -0.10
4) Cash Return on Liabilities	$\frac{\text{Net Income} + \text{Depreciation} + \text{Depletion} + \text{Amortization}}{\text{Total Liabilities}}$	> 0.10
5) Net Profit	$\text{Revenues} - \text{Expenses}$	> 0

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Glossy annual reports, SEC 10K reports and FERC Form 2 reports are based on full-scale audits. Consequently, EPA considers them the functional equivalent of an auditor's opinion.

A company that is a subsidiary of a large corporation can submit its parent company's financial statements if the company guarantees to pay to plug its subsidiary's wells. The parent corporation must own at least 50 percent of the subsidiary's voting stock; it will be bound to its guarantee until released by EPA. Such guarantees typically are made in writing to the EPA Program Director by a corporate officer who is authorized to legally bind the parent corporation.

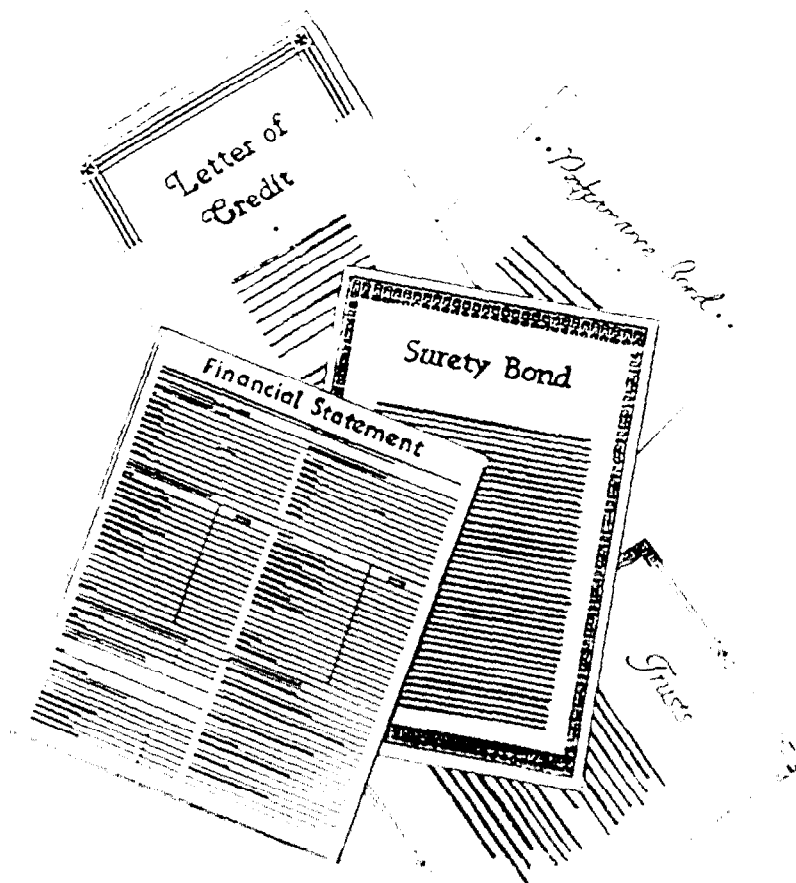
United States  
Environmental Protection  
Agency

EPA 570/9-90-003  
May 1990

Office of Water (WH-550)



# Federal Financial Responsibility Demonstrations for Owners and Operators of Class II Oil- and Gas-Related Injection Wells



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## **You May Be Authorized To Use Blanket Coverage By The UIC Program Director Upon His Review Of The Following Criteria:**

- Your company has a history of adequately plugging wells.
  - Your company has at least 1 field or lease with an estimated economic life of at least five years.
  - Your company has been in business at least 5 years. and
  - Your company operates more than 10 injection wells.
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the financial instrument that is right for your company. Cost is likely to be a prime consideration.

Various financial institutions can help you identify the most cost-effective instrument. Your insurance agent should have information about surety bonds including their availability, cost, and collateral requirements, if any.<sup>2</sup> Banks, savings and loans, and similar institutions can tell you about letters of credit and trust funds.

The cost of financial instruments has various components. As you evaluate different instruments, you should keep in mind these cost elements: Fees or premiums, collateral requirements, tax consequences, possible effects on your credit rating, and opportunity cost. Opportunity cost is the income you lose by tying up funds in a financial demonstration to EPA, rather than investing them in ways that would bring a higher return.

The fees or premiums for surety bonds, trust funds, or letters of credit will vary from one institution to the next. Bonds or letters of credit usually carry fees based on a percentage of their guaranteed amount. Trust fund premiums can be either fixed fees or a percentage of the funds managed by the trustee.

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<sup>2</sup>Since EPA cannot liquidate property such as equipment to secure cash, "collateral bonds" are not accepted.

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## **Making Your Submission**

Once you have selected a financial coverage option and a financial demonstration mechanism, you must gather the necessary information and documents and submit them to EPA. This step may require you to obtain a bond from a surety agent, request financial statement information from your accounting department, or obtain a letter of credit and standby trust agreement from a bank.

Your EPA Regional Office can give you model forms and sample documents for the information you are required to submit. The EPA Regional Office will not begin evaluating your submission until all the necessary certifications and representations are received. If you submitted items and information that meet the Agency's criteria and received EPA's approval, then you have met your obligation to demonstrate financial responsibility.

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## **Appendix B USEPA Regional Offices UIC Program Offices**

### **EPA Region I**

John F. Kennedy Federal Building  
Room 2203  
Boston, MA 02203  
(617) 565-3600

Connecticut, Maine, Massachusetts,  
New Hampshire, Rhode Island, Vermont

### **EPA Region II**

26 Federal Plaza  
New York, NY 10278  
(212) 264-1800

New Jersey, New York, Puerto Rico,  
Virgin Islands

### **EPA Region III**

841 Chestnut Street  
Philadelphia, PA 19107  
(215) 597-9928

Delaware, District of Columbia,  
Maryland, Pennsylvania, Virginia,  
West Virginia

### **EPA Region IV**

345 Courtland Street, N.E.  
Atlanta, GA 30365  
(404) 347-3866

Alabama, Florida, Georgia, Kentucky,  
Mississippi, North Carolina, South  
Carolina, Tennessee

### **EPA Region V**

230 South Dearborn Street  
Chicago, IL 60604  
(312) 353-4150

Illinois, Indiana, Michigan, Minnesota,  
Ohio, Wisconsin

### **EPA Region VI**

1445 Ross Avenue  
12th Floor, Suite 1200  
Dallas, TX 75270  
(214) 655-7160

Arkansas, Louisiana, New Mexico,  
Oklahoma, Texas

### **EPA Region VII**

726 Minnesota Avenue  
Kansas City, KS 66101  
(913) 551-7032

Iowa, Kansas, Missouri, Nebraska

### **EPA Region VIII**

999 18th Street  
Suite 500  
Denver, CO 80202-2405  
(303) 293-1413

Colorado, Montana, North Dakota,  
South Dakota, Utah, Wyoming

### **EPA Region IX**

215 Freemont Street  
San Francisco, CA 94105  
(415) 705-2111

Arizona, California, Hawaii, Nevada,  
American Samoa, Trust Territories of the  
Pacific, Guam, Northern Marianas

### **EPA Region X**

1200 Sixth Avenue  
Seattle, WA 98101  
(206) 442-1225

Alaska, Idaho, Oregon, Washington